FISCAL NOTE

Bill #: SB 13

Title: Clarify taxation of certain software as intangible property

Primary Sponsor: Dan Harrington

Status: Introduced

Sponsor signature Date

Chuck Swysgood, Budget Director Date

Fiscal Summary

	FY2003 Difference	FY2004 Difference	FY2005 Difference
Expenditures:			
General Fund	$48,837	0	0
Revenue:			
General Fund			
(95 Mill Levy)	$2,079,553	$2,079,553	$2,079,553
(Vo-Tech 1.5 Mill Levy)	$11,821	$11,821	$11,821
State Special Revenue			
(University 6 Mill Levy)	$131,340	$131,340	$131,340
Net Impact on General Fund Balance:	**$2,042,537**	**$2,091,374**	**$2,091,374**

Yes	No		Yes	No	
X		Significant Local Gov. Impact	X		Technical Concerns
	X	Included in the Executive Budget	X		Significant Long-Term Impacts
	X	Dedicated Revenue Form Attached		X	Family Impact Form Attached

Fiscal Analysis

ASSUMPTIONS:

1. SB 13 proposes to tax software that is depreciable or amortizable according to the Internal Revenue Code. SB 111, passed by the 1999 legislative session, exempted from Montana property taxation, intangible personal property including software.
2. The increase in taxable value due to exempt property becoming taxable is considered newly taxable property (15-10-420, MCA), and therefore state and local governments (county and city) could collect new property tax revenue on this additional taxable value if they chose.
3. Currently, the department's administrative rules allow for intangible personal property to be removed from centrally assessed company's market value, based on a standard industry percentage. The current law industry percentages are:

5%	Railroad Companies	(applies to property class 12)
10%	Electric Companies	(applies to property classes 5, 9, 13)

15%	Telecommunications	(applies to property classes 5, 9, 13)
10%	Airlines	(applies to property class 12)
5%	Telephone Cooperatives	(applies to classes 5, 9)
5%	Pipelines	(applies to classes 7, 9)
5%	Electric Cooperatives	(applies to classes 5, 9)

4. Under the bill, it is estimated that the standard industrial percentages for centrally assessed property will change for each industry as follows:
   - 5% to 2% for Railroad Companies
   - 10% to 5% for Electric Companies
   - 15% to 5% for Telecommunications
   - 10% to 3% for Airlines
   - 5% to 3% for Telephone Cooperatives
   - 5% to 3% for Pipelines
   - 5% to 2% for Electric Cooperatives
5. Because the standard exemption schedules for intangible property are lower for each industry type, taxable values are expected to increase for each class of property. Total taxable value statewide for classes 5, 7, 9,12, and 13 are estimated to increase by $21,689,135 in fiscal 2003. See table on following page for increases by tax class.
6. Intangible software of locally assessed companies is considered class 8 property. Like centrally assessed companies, under this bill, intangible software of locally assessed companies is no longer exempt and is taxed at the class 8 taxable rate of 3%. SB 200 passed by the 1999 legislative session exempts from property taxation business equipment of company's with a market value of $5,000 or less. Currently, exempt property does not contribute to the $5,000 limit under SB 200. Under the proposal, intangible software is no longer exempt and would contribute to the $5,000 exemption limit.
7. In tax year 2002 (fiscal 2003), there are 1,325 businesses that reported owning exempt intangible software with a total market value of $6,609,042. Of the total $6,609,042 market value of intangible software, $6,540,645 will become taxable. There are 174 businesses that would still have total class 8 property value less than $5,000, and therefore are exempt under SB200. 1,125 of the 1,325 businesses that reported intangible software have a current law total class 8 market value in excess of $5,000. Those 1,125 businesses reported a combined market value of intangible software of $6,540,645. Under the proposal, the $6,640,640 in intangible software will have a taxable rate of 3%; the class 8 taxable rate. The new taxable value associated with those 1,125 businesses is $196,219 ($6,540,645 x 3%). It is anticipated that 26 businesses currently exempt under SB 200 will reach in excess of $5,000 in total class 8 property and become taxable due to this bill. It is estimated that each of the 26 businesses will have a total class 8 market value of approximately $6,000; for a total combined market value of $156,000 (26 x $6,000). New taxable value associated with these 26 businesses is $4,680 ($156,000 x 3%). The estimated impact on class 8 taxable value is an increase of $200,899 ($196,219 + $4,680) in fiscal 2003.
8. The fiscal 2003 total statewide change in taxable value is $21,890,034. (See table for by class change in taxable value).
9. Applying the state 95 mill levy to the $21,890,034 increase in taxable value, equates to an increase in tax liability of $2,079,553 ($21,890,034 x 95 mills).
10. Under the proposal, the 6 mill university mill levy, 20-25-423, MCA, will also see an increase in revenue. Like the 95 state mill levy, the university 6 mill is applied to statewide taxable values. Applying the 6-mill University levy to the statewide increase in taxable value of $21,890,034; is an estimated increase in tax liability of $131,340 ($21,890,034 x 6 mills).

11. According to 20-25-439, MCA, the 1.5 mill Vo-Tech mill is levied in five counties: Silver Bow, Cascade, Yellowstone, Missoula, and Lewis and Clark. These five counties make up approximately 36% of total statewide taxable value. This analysis assumes that the five counties will have the same proportional increase in taxable value as the entire state. The fiscal 2003 property tax base of the Vo-Tech mill levy is estimated to increase by approximately $7,880,400 ($21,855,410 x 36%) in taxable value. Applying the Vo-Tech 1.5 mill levy to the estimated $7,880,400 increase in taxable value is an increase in tax liability of $11,821 ($7,880,4000 x 1.5 mills).
12. Total tax liability for the General Fund is estimated to increase by $2,222,714 ($2,079,553 + $131,340 + $11,821) in fiscal year 2003. For this analysis, the projected $2,222,714 increase in General Fund revenue increase is held constant for fiscal years 2004 and 2005.

Current Law V. SB 13
Fiscal 2003

Tax Class	Current Taxable Value	SB 13 Taxable Value	Est. Change Taxable Value	Estimated Change in Tax Liability: 95 Mills	6 Mill Univ.	1.5 Mill Vo-Tech	Total
5	34,818,729	35,922,628	1,103,899	104,870	6,623	596	**112,090**
7	216,414	223,248	6,834	649	41	4	**694**
8	119,096,412	119,297,311	200,899	19,085	1,205	108	**20,399**
9	207,257,098	216,004,831	8,747,733	831,035	52,486	4,724	**888,245**
12	46,607,820	48,295,672	1,687,852	160,346	10,127	911	**171,384**
13	137,154,037	147,296,854	10,142,817	963,568	60,857	5,477	**1,029,902**
Total	**545,150,510**	**567,040,544**	**21,890,034**	**2,079,553**	**131,340**	**11,821**	**2,222,714**

13. Currently, there are 1,325 owners with intangible software being exempted by local county offices. In order to determine if these properties are depreciated according to the IRS, each property owner or accountant would need to be contacted by the department. DOR anticipates approximately 30 minutes per contact, for a total allocated time of 662.5 (0.5 hours x 1,325 properties), or 0.38 (662.5 ÷ 1760 hours) FTE. This bill also creates situations where property exempt under SB 200 would now be taxable. To account for the change from exempt to non-exempt status, DOR estimates an additional 6 hours of processing time and 29 hours of audit time, or 0.02 FTE (35 ÷ 1760) will be needed to comply with the bill. Audit and process time requires a total of 0.4 FTE (0.38 + 0.02) property valuation specialists at grade 11. Administrative salary costs for processing and audit time are estimated at $8,742 (0.4 x $21,857).
14. Considering the bill is retroactive to tax years beginning after December 31st 2001, this would mean that taxable values would need re-certification. Re-certification includes balancing the state report to the county systems, the determination of newly taxable property for each jurisdiction, and sending notification to each jurisdiction. Each county would require 40 hours of grade 11 property tax specialist hours for a total of 2,240 hours, or 1.3 FTE (2,240 ÷ 1760). In addition, 40 hours, or 0.02 FTE (40 ÷ 1760) for a grade 15 tax policy analyst will be required to calculate newly taxable property. Personnel costs in salary for re-certifcation are estimative at $29,038 (1.3 x $21,857 + 0.02 x $31,205) Costs to mail new assessment notice are estimated at $835 (1,547 locally assessed parcels + 120 centrally assessed parcels x $0.50 per assessment).
15. Total administrative costs to re-certify taxable values are estimated to be $29,873 ($29,038 + $835)
16. Due to the retroactive provision of the bill, 120 centrally assessed companies will need to be revalued for tax year 2002. It will take approximately 4 hours per appraisal. Four appraisers would require 4.8 weeks to

complete the appraisals. Assuming the process would need to be completed in two weeks, it would require 160 hours of overtime by appraisers, or 0.08 FTE at grade 15. This equates to an estimated salary cost to revalue the 120 centrally assessed companies of $3,601 (0.08 x $31,205 x 1.5).

16. Benefits for the additional 1.8 FTE (1.7 property valuation specialist + 0.08 appraiser + 0.02 tax policy analyst) needed under the proposal are $6,621.
17. Total estimated one-time DOR administrative costs for fiscal 2003 are $48,837 ($8,742 + $29,873 + $3,601 + $6,621).

FISCAL IMPACT:

	FY2003 Difference	FY2004 Difference	FY2005 Difference
Expenditures:			
Personal Services	$48,002	$0	$0
Operating Expenses	$835	$0	$0
TOTAL	$48,837	0	0
Funding:			
General Fund (01)	$48,837	$0	$0
Revenues:			
General Fund (01)			
(95 Mill Levy)	$2,079,553	$2,079,553	$2,079,553
(Vo-Tech 1.5 Mill Levy)	$11,821	$11,821	$11,821
State Special Revenue (02)			
(University 6 Mill Levy)	$131,340	$131,340	$131,340
Net Impact to Fund Balance (Revenue minus Expenditure):			
General Fund (01)	$2,042,537	$2,091,374	$2,091,374
State Special Revenue (02)	$131,340	$131,340	$131,340

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:

1. Under the proposal, revenue for local governments would increase significantly due to the $21,855,410 increase in statewide taxable value. The increase in taxable value due to exempt property becoming taxable is considered newly taxable property, and governments could collect new property tax revenue on this new taxable value if they chose. At current mill levy levels; DOR estimates an increase of $6,650,000 in local government revenues. This bill has a retroactive date of Dec. 31st 2001. Supplemental and additional tax bills will have to be issued, and local governments will need re-certification of taxable values.

LONG-RANGE IMPACTS:

1. Higher revenues would continue

TECHNICAL NOTES:

1. This bill has a retroactive date of Dec. 31st 2001. Supplemental and additional tax bills will have to be issued, and local governments will need re-certification of taxable values. Re-certification includes balancing the state report to the county systems, the determination of newly taxable property for each

jurisdiction, and sending notification to each jurisdiction. Because SB13 is retroactive, it would require the department to revalue all centrally assessed companies for 2002. The department would adjust the default percentage down to account for the new taxation of depreciable software. This revaluation will require time for appeals and re-certification of values statewide. The department could have the revised valuations complete by August 30. Taxpayers have 30 days to request an informal review: it is assumed that all reviews could be handled within 30 days (September 30). The department would then need approximately two weeks to run assessment notices forward to the county offices and companies (October 14). At best, this would mean that the department could accomplish the re-certification of centrally assessed property by October 14. The department's local offices would then require additional time to provide certified values to local governments. The entire process could easily take until the first of November. Local governments would then be required to determine and re-certify their mill levies. If the certification process takes this long, it will be necessary to extend property tax deadlines

2. The same result of adding new language can be achieved by striking software. Software is basically accounted for in three ways: (1) included with hardware, not a separate purchase like a new computer and Microsoft Office; (2) is expensed; (3) or capitalized, which is usually expensive software that has a longer useful life. In the first situation, the software is not separated from the cost of the hardware, so it will not be reported separately. In the second situation, the software is expensed so it never ends up on a company's asset ledger, therefore it too typically is not reported. The third situation, where the software is capitalized is the only case where the software would be taxed. Under the bill as written the only taxable software would be capitalized software.
3. To timely and effectively administer the valuation of intangible personal property, the fiscal note is based on the following method to provide for valuing intangible personal property owned by centrally assessed companies. This concept, and language, is taken from the current administrative rules that were co-developed in the spring of 2000 by the department and industry representatives through the negotiated rule making process. The department has determined the percentages based on analysis that was conducted at the time of the negotiated rule making process, and a current review of software as a percent of costs for several companies. By not clearly stating how the valuation of intangible personal property is to be handled for tax year 2002, revising valuations could potentially be more challenging than assessing the original valuations.